

Answer **three** questions. Each question is worth [20 marks].

1. Study the extract below and answer the questions that follow.

Demand for chicken up after price cut

- ① There has been a fall in the demand for chicken following the avian flu¹ scare which led to people being afraid to eat chicken for fear of becoming ill. In response to this, chicken farmers reduced the selling price.
- ② Yesterday, there was a 10 per cent increase in the sales of both processed chickens and live chickens, with some 800 000 birds sold in the market nationwide. The price cuts were agreed upon at a meeting of the Federation of Livestock Farmers' Association, Malaysia (FLFAM). The FLFAM is a cartel, which sets prices for livestock sales in Malaysia. It controls 80 % of the suppliers in the country. Processed chicken now costs only RM² 3.20 per kg and live chicken RM 2.80 per kg. Previously, the prices were RM 4.00 and RM 3.50 respectively.
- ③ "The response is good and we hope that consumers now realise that chicken sold in Malaysia is safe to eat," said a FLFAM spokesperson, adding that the industry was worried when chicken sales dropped by 300 000 a day following the avian flu outbreak in neighbouring countries. Some 1.1 million chickens are available daily to meet consumer demand.
- ④ The spokesperson said that the drop in prices was to overcome the excess supply of chicken in the market, adding that poultry farmers in the country were holding an "Eat Chicken" campaign and were considering other marketing schemes. "We will continue with the current production of chicken," he said, "we have decided not to reduce the supply as planned earlier when sales dropped."
- ⑤ It was feared that, if the supply were reduced, then the **maximum price** of chicken that had been fixed by the Agriculture Ministry, would have to be increased. The FLFAM was considering getting their baby chick supply for production from abroad, especially from Australia and the European Union countries. These would take the place of supplies from neighbouring countries, although the prices of the new imports would be higher.
- ⑥ Cattle farmers were initially hoping that the misfortune of the chicken farmers might lead to a bonus for them. However, a positive **cross elasticity of demand** and a fall in the price of chicken is now likely to hurt suppliers of beef and lamb if the demand for chicken continues to rise.

¹ avian flu – a disease that humans contract from eating chicken

² RM – Malaysian Ringgit

[Source: adapted from *The New Straits Times*, Malaysia, February 2004]

(This question continues on the following page)

(Question 1 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) maximum price (*paragraph 5*) [2 marks]
 - (ii) cross elasticity of demand (*paragraph 6*). [2 marks]
- (b) Using a supply and demand diagram, explain why there was an “excess supply of chicken in the market” (*paragraph 4*). [4 marks]
- (c) Using an appropriate diagram, explain the likely effect of importing higher priced baby chicks from Australia and the EU on the market for chickens. [4 marks]
- (d) Using information from the text and your knowledge of economics, especially elasticity of demand, evaluate the economic situation facing the chicken farmers and consumers of chicken. [8 marks]